VODAFONE TAX DISPUTE

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ABSTRACT

This paper highlights details of the Vodafone tax dispute as it happened. The various parties involved were corporate entities including Hutchison, Hong Kong; Vodafone, Indian Judiciary; and India's Income Tax Department. This study also refers to various tax laws as specified in India's Income Tax Act.

Further, this paper answers how the business of the concerned entities was impacted by the highlighted legal dispute and also refers to the amendments in existing laws.

KEYWORDS: Assessing officers, Tax Avoidance, Tax Evasion, Capital Gain, Shell Company, TDS, Foreign Company, Joint Venture (JV) and Non-Resident Company.

INTRODUCTION:
This paper highlights details of the Vodafone tax dispute as it happened. The various parties involved were corporate entities including Hutchison Hong Kong & Vodafone, Indian Judiciary, and India's Income Tax Department. This paper also refers to various tax laws as specified in India's Income Tax Act.

Further, this paper answers how the business of the concerned entities was impacted by the highlighted legal dispute, what laws were amended and what new laws/amendments are expected.

Basic Terminology of Taxation System:
As we will be intensively making use of various terminologies from taxation domain, let us introduce the most important ones in this section:

1.1. Residential Status of Company:
As per the Income Tax Act, 1961, "a company is said to be resident in India in any previous year (PY) if it satisfies at least one of the following two conditions:

1. It's an Indian company.
   - An Indian company means a company formed and registered under the Companies Act of India.
2. Its place of effective management, in that year, is in India.
   - Effective management is the place where the meetings of directors, who manage and control the business, are held in India".

1.2. Tax Deducted at Source on Non-Resident Payments (Section 195):
Section 195 defines the Tax deducted at source (TDS) by the non -resident on the payments made. It also defines the rate of taxes, amount of deductions on corporate deals and businesses related to the non-resident.

As per Section 195, "The income is chargeable under the Income Tax Act". All amount of money is chargeable to tax is the amount that is paid which has the character of income and gross amount. Income Tax Act clarifies the provisions regarding the tax-avoidance in revenue which is out of a tax liability generated in the hands of non-residents or foreign residents. For doing the same, it is the duty of the buyer to deduct the amount of TDS from the payment is to be made.

Buyer or Payer is the person who is remitting the sum to foreign resident seller or payee. The payer can be domestic Company, Individual, Non-residents, Hindu Undivided Family, Firms, foreign companies, or any persons with exempted income in India and any juridical person regardless of whether that person has income taxable in India or not.

So, it is the duty of the buyer to deduct TDS before making payment to the seller, who is a non-resident.

1.3. Capital Gains Tax:
Capital gain is applicable on sale of capital assets. Capital gains tax is based on the difference between selling price and cost price. The original cost price is known as cost of acquisition. Cost of improvement and selling cost, like commission, are deductible before calculating profits.

1.4. Assessing Officer:
An Individual Officer of India's Income-tax department who is entrusted with this task of assessment of taxes is called as Assessing Officer (AO). AO has jurisdiction to assess a taxpayer who is liable to pay taxes under the Act.

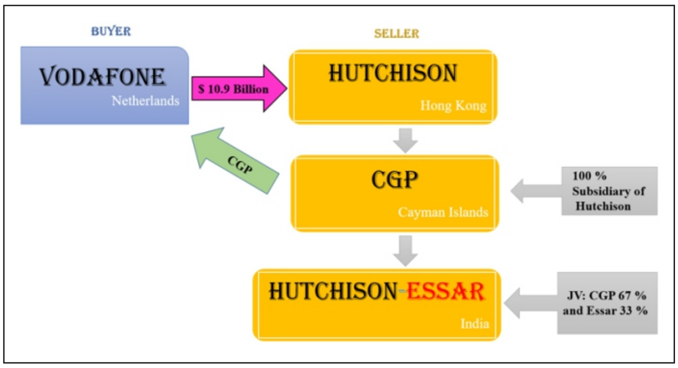
1.5. Tax Avoidance:
The use of legal methods to smartly modify individual/corporate income so that total tax liability goes down is known as tax avoidance.

1.6. Tax Evasion:
Tax evasion involves illegal actions by an individual or entity to intentionally avoid payment of true tax liability.

Acquisition of Hutch by Vodafone:
Hutchison Telecommunications International Limited (HTIL), a company based in Hong Kong (HK) was a non-resident in India. It was the seller in this transaction and the earner of capital gains. It had no tax implications in India. CGP Investment Holdings Ltd (CGP) was a 100% subsidiary of Hutchison HK and was incorporated in the Cayman Islands in 1998. The Cayman Islands historically has been a tax haven destination. CGP was incorporated by Hutchison to exclusively make an investment in Hutchison-Essar in India.

Hutchison-Essar was a JV between Hutchison and Essar Group. It was an Indian company in which CGP was holding around 67 % shares and Essar had a total holding of approximately 33 % only. In the year 2007, Hutchison sold CGP to Vodafone for $10.9 billion and Vodafone made the payment of the full amount without deducting TDS to Hutchison.

Vodafone International Holdings BV (Vodafone), incorporated in the Netherlands, was treated as a foreign company in India.



The Legal Battle Fought:
1. **Income Tax Department (India):** As per India's Income Tax Department, CGP was a letterbox company set up in a tax haven. The biggest question was its valuation of $ 10.9 billion, which was paid as a consideration by Vodafone for buying the same

The authority issues notice to Vodafone, treating as a defaulter for failing to withhold tax gains arising to Hutchison HK on the sale of the shareholding of CGP.

The only motive of this transaction was to control 67% shares in Hutchison-Essar in India. CGP is a sham entity. It doesn't produce anything and has not invested anywhere in the world but Hutchison-Essar in India. The valuation of CGP was entirely based upon its Indian asset i.e. shares of Hutchison-Essar. Accordingly, the Income Tax Department proceeded with its demand for TDS on capital gains from the buyer/payer in the concerned transaction i.e. Vodafone.

2. **Vodafone:** In its reply to the Income Tax Department, Vodafone said that it has not purchased Hutchison-Essar, an Indian company, rather has purchased CGP which is a foreign company. This transaction does not come under the jurisdiction of India's Income Tax as none of the two parties are Indian. The deal was made abroad and not in the Indian Territory.

3. **Bombay High Court:** This transfer of shares from CGP to Vodafone amount to sale of the controlling interest in the Indian company. Indirectly Vodafone acquired Hutchison-Essar, an Indian entity. Hutchison HK has earned capital gains, which are taxable in India. As per Section 195, It was the liability of Vodafone to deduct tax at source before the payment to Hutchison HK, a non-resident.

   The judgment passed by Bombay High Court was against Vodafone. They asked Vodafone to pay taxes in India.

4. **Supreme Court of India:** After the judgment of Bombay High Court, Vodafone filed a review petition in Honorable Supreme Court of India. As per the apex court, the Assessing Officer of the Income Tax Department in India has no authority to tax the international transaction. The shares of CGP, a foreign company, were transferred between two non-resident companies.

   Further, transfer of shares of a foreign company which has an Indian subsidiary does not amount to transfer of a capital asset in India. Income tax does not cover the income arising from indirect transfers. Controlling interest of a holding company is a subsidiary company is not a capital asset.

   Supreme Court rejected the decision of Bombay high court and stated that Vodafone was not required to deduct TDS.

Impact on Business:
Economic Times reported on Mar 17th, 2012 that "the direct tax collection was fallen short by INR 32,000 crore of the 2011-12 Budget estimates". These figures were published in response to the Supreme Court's decision that Vodafone is not liable to pay any tax in 2012. This led to aggressive tax amendments by the Government of India resulting in more complex laws for business to understand. Citing these amendments, the Income Tax Department sent a renewed tax notice of $2 billion to Vodafone in February 2016.

This was not the first time Vodafone has been involved in tax avoidance issue. As per Wikipedia.org, Vodafone has been involved in the purchase of Mannesmann by a Luxembourg subsidiary set up to avoid paying tax on the purchase deal in 2010 with projected savings of 6 billion pounds. Further, in 2011, Vodafone's Zug office borrowed money from swiss branches of a Luxembourg company benefitting it in saving taxes in both the countries up to the tune of 2 billion pounds. It seems that Vodafone has set up some sort of culture to twist laws and utilize loopholes in tax laws to its advantage.

Another impact to be noticed is from investors and customers perspective. Would it make sense for Vodafone to put the profits on its books which it claims to have saved by not deducting inapplicable capital gain tax? How can investors keep their belief and confidence in the organization? With these year-long battles and huge litigation costs, how does Vodafone keep its operating profits up and running? Do its customers need to shell out the cost from their pockets – either by paying higher charges or same charges for lower quality services?

Stand/Opinion about the case:
Clearly, Vodafone has very smartly and prudently managed to avoid taxes on the transaction. With all respect to the Honorable Supreme Court of India, the following two main questions remain unanswered:

1. What was the true purpose of CGP?
   - What we know for sure is that it was a company only on papers also known as Shell Company.
2. Why Vodafone did not buy a 67% share of Hutchison-Essar directly?
   - Did Vodafone's Merger & Acquisition Team think of purchasing shares from CGP, instead of Hutchison HK?
   - Did Vodafone's Finance Team intentionally decide to purchase shares from Hutchison HK to save capital gain taxes in the tune of $2.5 billion?

Is New Law or Amendment to Existing Law Required?
It is important for the progressive growth of our nation that people and entities are not allowed to twist the laws to their benefits. An honest tax payer's interest must be protected. It is believed that an amendment to existing laws is a must. Let's see a few amendments, highlighted in Economic Times article dated Mar 17th, 2012 made by Government of India in 2012-13 Union budget to bring similar transactions under the jurisdiction of India's taxation system:

I. The court clarified the definition of controlling interest and made an amendment with retrospective effect. "Section 2(14) includes and shall be deemed to have always included any rights in or in relation to an Indian company, including rights of management or control or any other rights".

II. The meaning of 'transfer' has been amended retrospectively. "It includes and shall be deemed to have always included disposing of or parting with an asset or any interest by seller, thereby creating an interest in any asset in any manner whatsoever for buyer, directly or indirectly, absolutely or conditionally, voluntarily or involuntarily, by way of an agreement (whether entered into in India or outside India)".

III. The Government also amended Section 195 related to TDS. "Section 195 of the Act always applied and extends and shall be deemed to have always extended to all persons, resident or non-resident irrespective of whether such person has a residence or place of business or business connection or any other presence in any manner whatsoever in India".

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